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SJ Advisors Report: Non-Payment of 38 Studios Moral Obligation Would Likely Reduce R.I. Bond Rating to ‘Junk’ Status

Impact on Rhode Island’s Reputation and Financial Standing Would Be Severe

Providence, R.I. — The Rhode Island Department of Administration announced today the release of a report by SJ Advisors that analyzed the potential financial and reputational impacts on the state of either payment or nonpayment of the moral obligation bond debt service associated with the 38 Studios bankruptcy.

Based on its analysis, the independent financial consulting firm of SJ Advisors concluded that Rhode Island debt would be downgraded from AA to the single B category by Standard & Poor’s Rating Services, which is below investment grade (speculative status) and from Aa2 to the Ba category (double B equivalent) by Moody’s Investment Service. This would put Rhode Island as the lowest state bond rating in the nation and would be considered “Junk Bond” status by the industry. SJ Advisors noted in its conclusions that “We expect that the rating agency reaction will be swift and severe, and that there will be a material and adverse effect on both the interest rates that the state pays when it issues debt and the market value of outstanding Rhode Island bonds.”

When SJ Advisors developed its assessment model, it created it to show the best, middle and worst case scenarios. In its detailed report, SJ Advisors found that even under its best case scenario, the state is financially better off fulfilling its obligations and making the payments for the moral obligation bonds. Under its best case scenario, the decision not to appropriate would

cost approximately \$36.0 million more than paying the debt service – with a net present value cost of about \$13.6 million. Should the worst case scenario come to pass, the net cost would be \$361.8 million – with the net present value cost at \$218.9 million. SJ Advisors believes that the middle case it developed in its analysis is the more likely scenario, where the net cost is estimated to be \$125.6 million more than paying the debt service - with a net present value of \$71.9 million.

“We must protect the state’s credit rating, its positive reputation and our access to the capital markets. That’s why I included \$12.5 million in my FY 2015 budget to meet its obligation,” Governor Lincoln D. Chafee said. “While this cost to taxpayers is distasteful, we are doing everything we can to reduce the size of the burden on our citizens through litigation. Repayment of these bonds is in the best interest to the state’s financial status and its reputation in the marketplace.”

SJ Advisors concluded after its in-depth analysis that “non-appropriation would result in a series of cascading events that would lead to increased costs associated with the state’s debt. It could also lead to a contagion effect impacting other Rhode Island issuers and even taint the business environment. Additionally, holders of Rhode Island debt would experience a decrease in the value of their bonds.” The report further indicated that the state’s ability to achieve savings through refinancing existing debt would likely be eliminated by the higher yields associated with the downgrade.

SJ Advisors’ analysis examined potential reactions by the bond rating agencies, developed analytical tools to calculate various scenarios the state could face should the state be unwilling to pay the debt service on the moral obligation bonds, analyzed the length of time and the extent of the reactions from the bond rating agencies, as well as explored other potential implications of non-appropriation.

Richard Licht, Director of the Department of Administration noted, “Rhode Island has enhanced its financial management practices and has made great strides in developing a strong reputation in the market. All that work will disappear in an instant should the state fail to meet its fundamental obligations. The state’s excellent credit is fundamental to ensuring we are attractive for businesses to grow and locate here, and it is essential to ensure we can make the necessary investments in our economy. Failure to make this payment would be a grave error for the future of the state.”

“One of the most compelling findings in this report is the increasing clarity of the swift actions we might expect from the rating agencies should the state fail to meet its obligation,” added Peter Marino, Director of the Office of Management and Budget. “This translates to projected financial and reputational costs that would have long term negative consequences to the state.”

Per the direction of the General Assembly in the FY 2014 Budget As Enacted to conduct a study of the implications of payment/non-payment of the moral obligation bond debt service, the

Department of Administration engaged SJ Advisors early in the year to complete this analysis for legislative consideration during the 2014 Legislative Session. SJ Advisors brings excellent credentials to this analysis and is registered with the Municipal Securities Rulemaking Board (MSRB) and the U.S. Securities and Exchange Commission (SEC). SJ Advisors will be presenting its report and its findings to the General Assembly on May 13 and May 14, 2014.

About SJ Advisors

SJ Advisors helps clients navigate the twists and turns of complex financial transactions, saving time and lowering costs. Its professionals work in close partnership with clients, creating customized solutions that allow them to realize their goals and objectives. They are proficient at educating clients on market dynamics and pricing to allow for more informed financing decisions. As an independent firm, SJ Advisors' advice is not limited by any pre-existing relationships or constrained to a specified set of available financial products. The firm is registered with the SEC and MSRB.

Mr. Steve Johnson, Founder and Principal at SJ Advisors, provides more than 20 years of professional experience in finance and management consulting. Mr. Johnson has served as financial advisor to municipal, higher education, health care and human service provider clients. Mr. Johnson advises on new and refinancing transactions involving publicly issued bonds, as well as bank purchased bonds, term debt, lines of credit, interest rate swaps and related financial products. Mr. Johnson holds a B.S. in electrical engineering from Rensselaer Polytechnic Institute, a Master's in controls and systems engineering from the University of West Florida and an MBA from the Wharton School at the University of Pennsylvania.

Ms. Linda Port joined SJ Advisors in 2014 as a senior vice president after nearly 25 years as a bond attorney and several years prior to that as a fiscal research analyst in the Office of Policy Evaluation and Analysis for the Pennsylvania Department of Revenue. Ms. Port has served as legal counsel to various non-profit higher education, health care and government organizations for a wide range of financial transactions. Ms. Port has served as borrowers counsel, bond counsel, and underwriters counsel, on transactions involving publicly issued bonds, bank purchased bonds, term debt, lines of credit, and other forms of debt. Ms. Port holds a J.D. from Boston College Law School, and a B.A. with a double major in Economics and Public Policy from Duke University.

Copies of the report are available on the Department of Administration's website at www.admin.ri.gov or a hard copy can be provided at 401-222-2280. Please contact Allison Rogers at 401-222-2280 with any questions.

Department or agency: Department of Administration

Online: www.admin.ri.gov